INDEX

	Page
Opinions below	1
Jurisdiction	1
Questions presented	2
Statutes and regulations involved	2
Statement	2
Argument	6
Conclusion	12
Appendix	13

CITATIONS

Cases:	
Blockton Cahaba Coal Co. v. *United States*, 24 F. 2d 180	8
Commissioner of Internal Revenue v. *Kennedy Laundry Co.*, 133 F. 2d 660, certiorari denied, 319 U. S. 770, rehearing denied, 320 U. S. 810	10
Consumers Natural Gas Co. v. *Commissioner*, 78 F. 2d 161, certiorari denied, 296 U. S. 634	10
Dobson v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231	9
Douglas v. *Commissioner*, Nos. 130–133, October Term, 1943, decided May 15, 1944	10
Enterprise Coal Co. v. *Phillips*, 84 F. 2d 565	6
Guanacevi Mining Co. v. *Commissioner*, 127 F. 2d 49	6
Helvering v. *American Dental Co.*, 318 U. S. 322	9
Marsh Fork Coal Co. v. *Lucas*, 42 F. 2d 83	6, 8
United States v. *Roden Coal Co.*, 39 F. 2d 425	6, 8
Virginian Hotel Corp. v. *Helvering*, 319 U. S. 523, rehearing denied, 320 U. S. 810	10, 11
Statutes:	
Revenue Act of 1934, c. 277, 48 Stat. 680:	
Sec. 23	13
Sec. 24	13
Sec. 113	14
Sec. 114	9, 14
Revenue Act of 1936, c. 690, 49 Stat. 1648:	
Sec. 23	15
Sec. 24	15
Sec. 113	15
Sec. 114	15

594087—44——1

Miscellaneous:

	Page
Treasury Regulations 86:	
Art. 23 (m)–1	15
Art. 23 (m)–15	7, 9, 16
Art. 24–2	16
Art. 113 (b)–1	17
Treasury Regulations 94:	
Art. 23 (m)–1	17
Art. 23 (m)–15	17
Art. 24–2	17
Art. 113 (b)–1	17

In the Supreme Court of the United States

OCTOBER TERM, 1944

Nos. 89–90

REPPLIER COAL COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court of the United States (R. 5–16) is unreported. The opinion of the circuit court of appeals (R. 22–28) is reported in 140 F. 2d 554.

JURISDICTION

The judgments of the circuit court of appeals were entered on February 19, 1944 (R. 28–29). The petition for writs of certiorari was filed on May 19, 1944. The jurisdiction of this Court is

invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the cost of constructing a major tunnel for the purpose of opening a new coal mining area may be treated by the coal company petitioner as a current business expense under Section 23 (a) of the Revenue Act of 1936 or must be treated as a capital expenditure recoverable through depletion allowances.

2. Whether profits realized by petitioner in selling supplies to its employees constituted "income from the property" as contemplated in Section 114 (b) (4) of the Revenue Act of 1934.

3. Whether depreciation deductions "allowed" in years prior to the ones here involved exhausted the cost bases of the assets, under Section 113 (b) (1) (B) of the Revenue Act of 1934.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and Regulations are set forth in the Appendix, *infra,* pp. 13–17.

STATEMENT

On August 14, 1922, petitioner acquired by assignment a coal lease, which was to expire on July 31, 1934. Upon the property covered by this lease, petitioner constructed a plant, hereinafter termed the New Castle Plant. Construction was begun in the fall of 1925 and completed in 1926

at a cost of $912,336.11. Petitioner also constructed a railroad siding on this leasehold during 1926 at a cost of $12,139.91. (R. 6–7.)

The useful physical life of the mining plant was 20 years at the time of construction. A new lease covering the tract, upon which petitioner had constructed the New Castle Plant, was granted to petitioner on August 1, 1934. The new lease was on a month-to-month basis, terminable by either party upon 30 days' notice. There have been no notices of termination. Until the execution of the lease on August 1, 1934, petitioner had no assurance that it would be executed. The New Castle Plant was constructed by petitioner without consideration of whether the then existing lease would be renewed. Accordingly, petitioner proceeded to claim depreciation deductions based upon the remaining life of the original lease (1930 return), and in the years to and including 1934 claimed as deductions the full amount of the cost basis. The deductions so claimed were not materially disturbed by the Commissioner. The petitioner received no tax benefit as to part of the deductions. (R. 8.)

In the notice of deficiency, the Commissioner disallowed depreciation of $99,108.10 for the year 1935 and $31,204.25 for the year 1936 with the explanation, "Excessive deduction for depreciation disallowed, because the assets acquired in previous years have been fully depreciated by

allowable deductions claimed in prior years" (R. 9).

A reasonable allowance for exhaustion, wear and tear of the New Castle Plant and the railroad siding during the years 1930 to 1934, inclusive, was five percent per annum of their respective costs (R. 9).

Under the petitioner's contract with the Miners' Union, petitioner was obliged to furnish to its miners dynamite and miners' supplies, and to rent them mine lamps at fixed charges to be deducted from wages payable. Petitioner's profit on these items was $10,156.25 in 1935 and $9,203.84 in 1936. On each of its returns for the years 1930 to 1934, inclusive, income from the sale of dynamite and supplies and from lamp rentals was listed as an item separate from its gross receipts from the production and sale of coal. (R. 9–10.)

Petitioner duly elected to deduct depletion on the percentage basis for the taxable years 1935 and 1936. The Commissioner excluded from income from the mining property the profit derived by petitioner on selling and renting mining supplies to its employees. At the same time, in computing net income from the mining property, the Commissioner deducted as miners' wages the full amount to which they were entitled under the terms of their contracts, without deduction therefrom on account of the charges made for the supplies sold or rented to the miners nor for the

profit realized by petitioner on such sales and rentals. (R. 10.)

During the year 1936, petitioner constructed a certain mine tunnel at a cost of $86,394.03, thereby making available for production 394,000 tons of coal. Of the coal so made available, petitioner produced and sold 5,659 tons in the year 1936. Petitioner's mine had long since passed the development stage. In the notice of deficiency, the Commissioner allowed petitioner percentage depletion for the year 1936 based upon income from its mining properties, which included income derived from the coal produced as a result of the construction of the tunnel. (R. 10.)

The Tax Court concluded that (R. 11) while deductions for depreciation taken on the petitioner's returns for the years prior to 1935 exhausted the cost basis of the assets, the deductions were not "allowed" (sec. 113 (b) (1) (B) of the Revenue Acts of 1934 and 1936) since they did not offset taxable income in full; that since the depreciation should be based upon the useful life of the properties rather than upon the limited life of the lease, the excessive deductions were not "allowable." As to this issue, the court below reversed (R. 28).

With respect to the profits derived by the petitioner from the furnishing of supplies to the miners, the Tax Court concluded that (R. 14–15) this profit could not be treated as "net income from the property" within the meaning of the

statute fixing the limit upon depletion allowances. On the issue involving the construction cost of the new tunnel, the Tax Court concluded (R. 16) the expenditure was of a capital nature and its cost must be recovered through depletion allowances and could not be deducted as a current business expense. As to these two issues, the court below affirmed (R. 25–26).

ARGUMENT

1. The decision of the court below that (R. 24) there was nothing in the statute or the Regulations which conflicts with the Tax Court's conclusion that the tunnel expenditure was of a capital nature and could not be deducted as a current business expense is not in conflict with *Guanacevi Mining Co.* v. *Commissioner,* 127 F. 2d 49 (C. C. A. 9th); *United States* v. *Roden Coal Co.,* 39 F. 2d 425 (C. C. A. 5th); and *Marsh Fork Coal Co.* v. *Lucas,* 42 F. 2d 83 (C. C. A. 4th), which are relied upon by the petitioner (Pet. 7).

In the *Guanacevi Mining Co.* case, the court fully sustained the position of the Government to the effect that the construction of the new tunnels and the installation of the new machinery and methods must be regarded as part of the development of what was in effect a new mine. The decision there is consonant with our position here, though it is not decisive of the issue here for either party.[1] We do not here

[1] *Enterprise Coal Co.* v. *Phillips,* 84 F. 2d 565 (C. C. A. 3d) (Pet. 19), occupies a similar posture.

contend that the taxpayer's coal mine was in the development stage and that the cost of the tunnel must for that reason be capitalized. Article 23 (m)–15 of Treasury Regulations 86 (Appendix, *infra*, p. 16), specified that many items of expenditure not inherently of a capital nature were to be capitalized if incurred during the development stage. Thus the problem is simplified in cases where it can be shown that the mine is still in the development stage. But the mere fact that the mine has passed the development stage does not entitle the taxpayer to deduct as current expense every type of expenditure. All that the Regulations said (Art. 23 (m)–15) was that certain expenditures "for equipment," necessary to maintain the normal output because of recession of the working face of the mine "and which (1) do not increase the value of the mine," might be deducted as current expenses after the development stage had been passed. But if in fact the expenditure was inherently of a capital nature, as the Tax Court here found, then the statute and the Regulations require that such cost be capitalized.

Other cases have properly held that expenditures for such minor equipment as car wheels, switches, trolley wires, and rails, necessary to maintain normal production after the mine has reached the producing stage, need not be capital-

594087—44——2

ized but may be treated as deductible expenses. On analysis, these cases do not militate against the Government's position here. The reasons given for allowing the deductions in such cases clearly indicate that a contrary decision should be reached in the case at bar. For example, in the *Roden Coal Co.* case, *supra,* the major expenditures were for new car wheels and for enlarging a four-inch water pipe to a six-inch pipe. The trial court specifically found that (39 F. 2d at p. 426) none of such items decreased the cost of producing the coal or added to the value of the coal mine, and that the expenditures were necessary in order to maintain the normal production of the mines, due to the constantly increasing depth of workings.[2] Compare *Blockton Cahaba Coal Co.* v. *United States,* 24 F. 2d 180 (C. C. A. 5th), where the same court said (p. 181):

> Money laid out in the construction of a coal mine to a greater depth is invested capital, just as much as is money spent to add a second story to a building that already is rented at a profit.

The *Marsh Fork Coal Co.* case, *supra,* may be similarly explained, in that the expenditures there involved were for extended trackage and additional mine train equipment, made necessary by

[2] The stipulation here is merely that (R. 18) the established production was not in fact increased materially following the completion of the new tunnel.

the gradual recession of the working area of the mine. Thus, unlike the instant case, the *Marsh Fork* and *Roden Coal* cases fall within the phraseology of Article 23 (M)–15 describing what may be deducted as current business expenses. (See Appendix, *infra*, p. 16.)

The court below was satisfied that the correct rule of law had been applied and that "there certainly was sufficient evidence to justify the Tax Court's treatment of the expenditure as a capital item" (R. 24). Hence there is no occasion to consider the question of the scope of *Helvering* v. *American Dental Co.*, 318 U. S. 322, and *Dobson* v. *Commissioner*, 320 U. S. 489, rehearing denied, 321 U. S. 231[3] (Pet. 8), dealing with the power of courts to review and reverse decisions of the Tax Court.

2. No conflict of authorities is asserted with respect to the holding of the court below that the Tax Court properly computed the petitioner's "income from the property," as contemplated in Section 114 (b) (4) of the Revenue Act of 1934 (Appendix, *infra*, pp. 14–15), which limits depletion deductions to fifty percent of that amount. The Tax Court found (R. 15) that the petitioner was obligated to pay its employees a fixed amount,

[3] Petitioner cites (Pet. 8) the *Dobson* case to show that the Circuit Court of Appeals should have given less weight to the decision of the Tax Court. However, the *Dobson* case seems peculiarly applicable, in the Government's favor, to the circumstances involved here.

and that the essential nature of the situation was the same as if the wages had been paid in full and a profit realized upon a separate phase of the transaction through the sale of supplies to the miners. As used in the statute, the phrase "income from the property" means only income derived from the operation which is depleting that property. Profits derived from selling supplies to miners engaged in that operation, even though a legitimate corporate activity, must be here excluded in view of the obvious purpose of the statute. See *Consumers Natural Gas Co.* v. *Commissioner,* 78 F. 2d 161 (C. C. A. 2d), certiorari denied, 296 U. S. 634. This issue presents no basis for the issuance of the writs.

3. The final ground asserted for the issuance of the writs is obviously without merit. In *Virginian Hotel Corp.* v. *Helvering,* 319 U. S. 523, rehearing denied, 320 U. S. 810,[4] this Court ruled that depreciation is "allowed" within the meaning of Section 113 (b) (1) (B) of the statute when it is claimed by the taxpayer and not opposed by the Commissioner, even though the taxpayer had insufficient net income to enjoy the full tax benefit of the deduction. The petitioner here is in effect asking for a reconsideration of the question (Pet.

[4] See also *Douglas* v. *Commissioner*, Nos. 130–133, October Term, 1943, decided May 15, 1944; *Commissioner of Internal Revenue* v. *Kennedy Laundry Co.*, 133 F. 2d 660 (C. C. A. 7th), certiorari denied, 319 U. S. 770, rehearing denied, 320 U. S. 810.

10). The court below properly concluded that (R. 28) the decision in the *Virginian Hotel* case was controlling on the depreciation issue here and that since the point merely involved the legal effect to be given to the statutory term "allowed," the decision of the Tax Court could to this extent be reversed without violating the principles announced in the *Dobson* case.

In view of the broad basis of the decision in the *Virginian Hotel* case, no material factual distinction can be established. The petitioner claims (Pet. 10) that the excessive depreciation allowances here were based upon a mutual mistake of law. Even if that assertion were true,[5] the result would not be affected for the statute in question is concerned with the fact of allowance rather than the reason for the allowance.

---

[5] Before the Tax Court, the Commissioner contended that even if it be assumed that the petitioner had the legal right to remove the depreciable property from the premises at the expiration of the lease, the property was of such a nature as to have only a salvage value; and that for this reason the accelerated depreciation during the term of the lease was proper under any view of the legal rights of the lessee, and that the depreciation was not only "allowed" but "allowable" as well.

CONCLUSION

The decision below is correct, and there is no conflict of authorities. The petition for writs of certiorari should therefore be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
J. LOUIS MONARCH,
JOSEPH M. JONES,
Special Assistants to the Attorney General.
WALTER J. CUMMINGS, JR.,
Attorney.

JUNE 1944.